Report

of the

Examination of

Flyway Mutual Insurance Company

Waupun, Wisconsin

As of December 31, 2002

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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May 23, 2003

Honorable Jorge Gomez
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, an examination has been performed as of December 31, 2002, of the affairs and financial condition of

FLYWAY MUTUAL INSURANCE COMPANY
Waupun, Wisconsin

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The last examination of this company was made in 1998 as of December 31, 1997. The current examination covered the intervening time period ending December 31, 2002, and included a review of such subsequent transactions deemed essential to complete this examination.

The Summary of Examination Results contains elaboration on all areas of the company's operations. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The company was originally organized as a town mutual insurance company on March 13, 1874, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the Waupun Farmers Mutual Insurance Company. Subsequent amendments to the company's articles and bylaws changed the company's name to that presently used.

During the period under examination, there were two amendments to the articles of incorporation and no amendments to the bylaws. The articles of incorporation were amended to reflect changes in the number of directors from twelve to ten and then again from ten to nine.

A review of the certificate of authority revealed that the company is currently licensed to write business in the following counties:

> Columbia, Dodge, Fond du Lac, Green Lake, Jefferson,
> Sheboygan, Washington, Waukesha, Waushara, and Winnebago

The company is currently licensed to write property, including windstorm and hail, and nonproperty insurance.

A review was made of the policy and application forms currently used by the company. The company issues an approved policy with or without endorsements for terms of three years with premiums payable on the advance premium basis.

Business of the company is acquired through seven agents, one of whom is a director of the company. Agents presently receive a 15% commission on all business.

The directors of the company adjust losses. Agents do not have authority to adjust losses; however, the company has one director/agent who can adjust losses. Losses in excess of $5,000 need to be adjusted by two or more directors. Directors receive $50.00 for each loss adjusted plus $.365 per mile for travel allowance. Additionally, the company hires a professional adjusting service when claims are projected to be over $50,000.

Policyholders may participate in the management and control of the company by attending and voting at all annual or special meetings of the members. No member may vote by proxy. The annual meeting of the company for the election of directors and special meetings of the company are held in accordance with its articles of incorporation.

Board of Directors

The board of directors consists of nine members divided into three classes. One class is elected at each annual meeting for a term of three years. Vacancies on the board may be filled by the directors for the interim to the next annual meeting when a director shall be chosen for the unexpired term.

The current board of directors consists of the following policyholders of the company:

Name	Principal Occupation	Residence	Expiry
Todd Cotterill	Farmer	Markesan, WI	2004
Richard Bille	Farmer	Brandon, WI	2004
Jeff Weinheimer	Farmer –Crop Spraying	Juneau, WI	2004
Dennis Grahn	Self Employed	Markesan, WI	2005
Doris Hopp*	Secretary/Treasurer and Agent	Waupun, WI	2005
Darwin Wetzel	Surgical Room Assistant	Burnett, WI	2005
Wayne Albright	Farmer	Ripon, WI	2006
Gerhardt Beske	Farmer	Fox Lake, WI	2006
Donald Vande Zande	Retired Controller (Waupun Utilities)	Waupun, WI	2006

Directors who are also agents are identified with an asterisk.

Members of the board currently receive $50 for each meeting attended and $.365 for mileage.

Officers

Officers are elected by the board of directors from among its members and hold office for one year or until their successors are duly elected and qualified.

Officers serving at the present time are as follows:

Name	Office	2002 Salary
Darwin Wetzel	President	$ 1,500
Wayne Albright	Vice President	0
Doris Hopp	Secretary/Treasurer	34,000

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Adjusting Committee	Executive Committee
Darwin Wetzel, Chairman	Darwin Wetzel, Chairman
Wayne Albright	Wayne Albright
Doris Hopp	Doris Hopp

Growth of Company

The growth of the company during the past five years as compiled from its filed annual statements was as follows:

Year	Net Premiums Earned	Net Losses and LAE Incurred	Policies In Force	Net Income	Admitted Assets	Policyholders' Surplus
1998	$385,262	$353,058	1,136	$(78,817)	$3,003,444	$2,402,225
1999	424,019	264,624	1,086	31,847	2,880,395	2,395,463
2000	350,035	193,596	1,053	27,427	2,971,224	2,474,706
2001	349,436	255,362	1,023	(49,376)	2,925,162	2,449,356
2002	374,127	171,828	1,024	48,375	2,799,063	2,356,085

The ratios of premiums written, gross and net, to surplus as regards policyholders during the past five years were as follows:

Year	Gross Premiums Written	Net Premiums Written	Ending Surplus	Writings Ratios Gross	Net
1998	$840,246	$399,493	$2,402,225	35%	17%
1999	803,608	391,685	2,395,463	34	16
2000	805,416	350,655	2,474,706	33	14
2001	805,789	351,286	2,449,356	33	14
2002	833,200	376,600	2,356,085	33	16

For the same period, the company's operating ratios were as follows:

Year	Net Losses and LAE Incurred	Other Underwriting Expenses Incurred	Net Earned Premiums	Loss Ratio	Expense Ratio	Composite Ratio
1998	$353,058	$250,685	$385,262	92%	63%	154%
1999	264,624	255,375	424,019	62	65	127
2000	193,596	249,394	350,035	55	71	126
2001	255,362	245,173	349,436	73	70	143
2002	171,828	254,238	374,127	46	68	113

The company’s composite ratio, which is combination of the loss and expense ratios, has been high during the past five years continuing the trend that was noted during the prior examination. As a result, the company has again reported underwriting losses in each of the last five years under examination. During the period under examination, the company’s investment income offset the losses for three of the past five years. Severe storms in 1998 and 2001 resulted in net losses and a 3.1% decrease in surplus over the past five years.

Policies in force decreased 17% during the current examination period, which was consistent with the long-term trend for the company. Consequently premiums written were also decreasing until the company raised rates in response to the increased underwriting losses. Despite the adverse trends noted, the company’s surplus continues to remain strong relative to its net premiums written.

II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed there is currently one ceding treaty. The treaty contained a proper insolvency clause and complied with s Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Company retentions of risk complied with s. Ins 13.06, Wis. Adm. Code.

Reinsurer:	Wisconsin Reinsurance Corporation
Effective date:	January 1, 2002
Termination provisions:	Either party may terminate this contract as of any subsequent January 1 by giving to the other party at least 90 days' advance notice in writing. In the event the contract is terminated, the company can elect either a cut off or a run off of the liability covered under the contract.

The coverages provided under this treaty are summarized as follows:

1.	Type of contract:	Class A Liability
	Lines reinsured:	All liability (nonproperty) peril
	Company's retention:	$1,500
	Coverage:	100% of any loss and loss adjustment expense in excess of $1,500 for each and every loss occurrence. Subject to policy limits of $1,000,000 for bodily injury and property damage liability, and $5,000 per person/$25,000 per accident for medical payments.
	Reinsurance premium:	75% of liability premium written
2.	Type of contract:	Class B First Surplus
	Lines reinsured:	All property perils
	Company's retention:	When the company's net retention is $300,000 or more, the company may cede on a pro rata basis up to $800,000. When net retention is less than $300,000, the company may cede on a pro rata basis up to 50% of such risk.
	Annual aggregate deductible	10% of loss and loss adjusting expense. This deductible shall be waived if the company exceeds the combination of the excess of loss retention and any excess of loss annual deductible.
	Coverage:	Pro rata share of each and every loss including LAE corresponding to the amount of the risk ceded less the annual aggregate deductible.
	Reinsurance premium:	100% of the unearned premium corresponding to the amount of the risk ceded.

	Ceding commission:	15% sliding scale with a min/max rate of 15/35%. The current rate is 15%.
3.	Type of contract:	Class C Excess of Loss – First Layer
	Lines reinsured:	All property perils
	Company's retention:	$30,000 per loss and a $25,000 annual aggregate deductible.
	Coverage:	100% of any loss occurrence, excluding LAE, in excess of $30,000 up to $70,000.
	Reinsurance premium:	The sum of the prior four years' losses divided by the total net premium written for the same period multiplied by 125%. Subject to min/max rates of 5.5%/22.6% of the current net premium written. The current rate is 11.61% of net premium written.
4.	Type of contract:	Class C Excess of Loss – Second Layer
	Lines reinsured:	All property perils
	Company's retention:	$100,000
	Coverage:	100% of any loss occurrence, including LAE, in excess of $100,000 subject to a limit of $200,000.
	Reinsurance premium:	2.4% of net premium written, minimum premium of $9,360.
5.	Type of contract:	Class D/E Stop Loss and Catastrophe Reinsurance
	Lines reinsured:	All property perils
	Company's retention:	72 Hour Catastrophe—$75,000 of each loss occurrence arising out of the same event during any period of 72 consecutive hours. Stop Loss—Annual aggregate losses, excluding LAE, equal to 75% of net premiums written subject to a minimum retention of $322,000.
	Coverage:	72 Hour Catastrophe—100% of each loss occurrence in excess of $75,000 up to $500,000. Stop Loss—100% of annual aggregate losses, excluding LAE, in excess of the retention.
	Reinsurance premium:	The sum of the prior eight years' losses incurred divided by the total net premiums written for the same period multiplied by 125%. Min/Max rate of 8.5%/25% of net premium written. The current rate is 14.5% of net premium written with a minimum premium of $62,880.

III. FINANCIAL DATA

The following financial statements were filed with the Commissioner of Insurance in the company's annual statement at December 31, 2002. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Policyholders' Surplus."

Flyway Mutual Insurance Company
Statement of Assets and Liabilities
As of December 31, 2002

Assets	Ledger	Nonledger	Not Admitted	Net Admitted
Cash in Company's Office	$ 216	$	$	$ 216
Cash Deposited in Checking Account	(8,292)			(8,292)
Cash Deposited at Interest	122,837			122,837
Bonds (at Amortized Cost)	1,485,705			1,485,705
Stocks or Mutual Fund Investments (at Market)	889,240			889,240
Real Estate	101,902			101,902
Premiums and Agents' Balances and Installments:				
In Course of Collection	48,640			48,640
Deferred and Not Yet Due	113,541			113,541
Investment Income Accrued		27,260		27,260
Reinsurance Recoverable on Paid Losses and LAE	2,869			2,869
Electronic Data Processing Equipment	14,212			14,212
Other Assets:				
Nonexpense Related:				
Federal Income Tax Recoverable	933			933
Furniture and Fixtures	1,929		1,929	
TOTALS	$2,773,732	$27,260	$1,929	$2,799,063

Liabilities and Surplus

Net Unpaid Losses	$ 66,655
Unpaid Loss Adjustment Expenses	5,500
Commissions Payable	26,543
Fire Department Dues Payable	251
Unearned Premiums	304,426
Reinsurance Payable	27,417
Amounts Withheld for the Account of Others	1,728
Payroll Taxes Payable (Employer's Portion)	579
Other Liabilities:	
Expense Related:	
Accounts Payable	1,500
Accrued Property Tax	2,954
Nonexpense Related:	
Premiums Received in Advance	5,425
TOTAL LIABILITIES	442,978
Policyholders' Surplus	2,356,085
TOTAL	$2,799,063

Flyway Mutual Insurance Company
Statement of Operations
For the Year 2002

Net Premiums and Assessments Earned		$374,127
Net Losses Incurred	144,019	
Net Loss Adjustment Expenses Incurred	27,809	
Other Underwriting Expenses Incurred	254,238	
Total Losses and Expenses Incurred		426,066
Net Underwriting Gain (Loss)		(51,939)
Net Investment Income:		
Net Investment Income Earned	117,491	
Net Realized Capital Gains	1,224	
Total Investment Income		118,715
Other Income:		
Miscellaneous	4,930	
Total Other Income		4,930
Net Income (Loss) Before Policyholder Dividends and Before Federal Income Taxes		71,706
Federal Income Taxes Incurred		23,331
Net Income (Loss)		$48,375

Flyway Mutual Insurance Company
Reconciliation and Analysis of Surplus as Regards Policyholders
For the Five Year Period Ending December 31, 2002

The following schedule is a reconciliation of surplus as regards policyholders during the period under examination as reported by the company in its filed annual statements:

	1998	1999	2000	2001	2002
Surplus, beginning of year	$2,395,984	$2,402,225	$2,356,463	$2,474,706	$2,449,356
Net income	(78,817)	31,847	27,427	(49,376)	48,375
Net unrealized capital gains or (losses)	77,253	(46,893)	44,483	(141,596)	16,513
Change in non-admitted assets	7,805	8,284	7,513,	(51)	7,513
Surplus, end of year	$2,402,225	$2,395,463	$2,474,706	$2,449,356	$2,356,085

Reconciliation of Policyholders' Surplus

There were no adjustments to surplus as a result of the examination.

IV. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

Comments and recommendations contained in the last examination report and the action taken on them by the company are as follows:

1. Corporate Records—It is recommended that the company annually appoint the members of all committees and record the appointments in its minutes.

   Action—Compliance

2. Corporate Records—It is recommended that the company fill directorships as required by its articles of incorporation or amend its articles of incorporation to reflect the current number of directors.

   Action—Compliance

3. Corporate Records—The company should give consideration to developing a comprehensive business plan to help provide assistance as to how it will achieve its goals.

   Action— This comment was made as a suggestion rather than a recommendation and therefore compliance is not statutorily required.

4. Underwriting—It is recommended that the company establish a formal inspection procedure for new and renewal business; whereby all new applications are inspected and an approach for inspecting renewal business is used, which targets categories of policies with high loss ratios in conjunction with a random sampling methodology.

   Action—Compliance

5. Underwriting—It is suggested that the company adopt procedures for obtaining pictures of all properties it inspects.

   Action—Compliance

6. Underwriting—In an effort to mitigate its underwriting losses, the company should consider performing some detailed loss analysis and a study of its expense structure over an extended time period. Some of the ways the company may consider analyzing its losses are by size of premium, size of policy, type of policy, location, and by agent.

   Action—Compliance

7. Claims Adjusting—It is recommended that the company adopt procedures that will minimize the potential conflict of interest adjusters may have adjusting losses of claimants who have a relationship with the adjuster

   Action—Compliance

8. EDP Environment—It is recommended that the company establish procedures to limit access to its computers.

   Action—Compliance

9 Net Unpaid Losses—It is recommended that the company adopt procedures for timely settlement of claims, in compliance with s. Ins 6.11 (3) (a) 2, Wis. Adm. Code.

Action—Noncompliance

Current Examination Results

Corporate Records

The minutes of the annual meetings of policyholders and meetings of the board of directors and any committees thereof, were reviewed for the period under examination and also for the subsequent period. During the review of corporate minutes it was noted that the company was not recording enough pertinent information to adequately document the Board's management of the business and affairs of the corporation. Some of the major areas of weakness were as follows: 1) The minutes to the September 2001 meeting indicated that the Board was passing the authority to make a decision about home office building repairs to the Executive Committee. However, the minutes to the Executive Committee meeting made no reference to any discussion on the building at all. 2) There were no discussions noted on how the company will comply with any prior OCI examination recommendations, such as adopting procedures for timely settlement of claims. 3) The Executive/Adjusting committee meeting minutes included who attended, where the meeting was held, date and time of the meeting, and a reference that the business being discussed all related to the agenda for Board meetings. Without adequately documented minutes to the Board, policyholders, or committee meetings, the examiner could not determine complete compliance with ch. 612 Wis. Stat. In particular the brevity of the minutes did not indicate compliance with s. 612.13 (3) which states that "the board shall manage the business affairs of the corporation and shall not delegate its power or responsibility to any person except specifically provided otherwise in this chapter". It is recommended that the Secretary of the company maintain minutes from board, committee, and annual policyholders meetings that more clearly indicate that the Board of Directors are actively managing the company in compliance with s. 612.13(3) Wis. Stat. Committee meeting minutes are discussed further in the Claims Adjusting section below.

The prior examination report commented that the company should consider developing a comprehensive business plan due to continued underwriting losses. Although there was no formal plan developed, it was noted that the Board had reviewed loss ratios and approved various policy related changes to help increase underwriting profits. However, the process of preparing a formal written plan will help the company to focus on strategies for achieving management's short and long term goals. Examples of areas of discussion may be policyholder retention (including any possible customer service related issues), expansion of business, improving underwriting expenses and loss ratios. Once developed this plan should be approved by the Board and noted in the minutes. It is recommended that the company develop a comprehensive business plan to help provide assistance as to how it will achieve its goals.

Biographical data relating to company officers and directors have been reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

The company has executed formal written agreements with its agents. The contracts include language indicating the agent will represent the company's interests "in good faith."

Conflict of Interest

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employes which conflicts or is likely to conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted such a procedure for disclosing potential conflicts of interest. Conflict of interest questionnaires were reviewed for the period under examination with two directors appropriately noting conflicts. One director was and is an agent for the company and a previous director noted that his spouse was an agent for the company.

Fidelity Bond and Other Insurance

The company is afforded coverage under the terms of the following bonds or contracts and has complied with s. Ins 13.05 (6), Wis. Adm. Code, which sets forth the minimum requirements for fidelity bond coverage:

Type of Coverage	Coverage Limits
Fidelity Bond	$ 140,000
Professional, Director, and Officer Liability	1,000,000
Worker's Compensation	500,000
Property and Equipment	249,000
Computer Equipment and software	49,000
General Liability	1,000,000

Underwriting

The company has a written underwriting guide. The guide covers all the lines of business that the company is presently writing.

The company has a formal inspection procedure for both new and renewal business. All new business is inspected and any renewal with a premium amount of $500 or more and any risk that involves a wood burning stove.

Claims Adjusting

The company has an adjusting committee consisting of at least three directors as required by s. 612.13 (4), Wis. Stat. and was created by naming the Executive Committee as the Adjusting Committee. However, the function of this committee is not clear. The examiner's review of the Executive/Adjusting Committee and Board meeting minutes indicated that claims over $1,000 were being discussed at board meetings and the agenda for the board meetings (with no specifics) was being discussed by the adjusting committee. Neither set of minutes adequately documented how the formation of the Executive/Adjusting Committee completely complied with regulatory requirements. According to s. 612.13(4), "the Directors shall annually appoint from their own numbers an adjustment committee of at least 3 persons to <u>adjust or supervise the adjustment of losses</u>". As noted in the Corporate Records section of this report, minutes to Board and committee meetings are intended to serve as documentation that Directors are managing the business and affairs of the corporation. The oversight of losses is an important part of this process and the Executive/Adjusting Committee meeting minutes should reflect that its members are either adjusting or supervising the adjustment of losses for the benefit of the company and its policyholders. The brevity of the adjusting committee minutes was discussed with the company and suggestions were made as to what the function of the committee could be. For example, discussions could be geared toward when to hire an outside adjuster, analysis of adjusting expenses in relation to actual cost of the service, analysis of loss ratios per agents and/or claimants, and compliance with claims handling procedures and regulatory requirements. It is recommended that the company clarify the function of the adjusting committee such that it performs the role defined in s. 612.13 (4), Wis. Stat. and note it in the minutes. Refer to the

Corporate Records paragraph for further discussion on the recording of minutes to corporate meetings.

Accounts and Records

The examiners' review of the company's records indicated that the company is in compliance with s. Ins 13.05, Wis. Adm. Code, which sets forth the minimum standards for the handling of cash and recording of cash transactions by town mutual insurance companies. The examiners noted the following:

1. A proper policy register is maintained
2. A proper cash receipts journal is maintained
3. A proper cash disbursements journal is maintained
4. A proper general journal is maintained
5. A proper general ledger is maintained

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, test checked for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2002.

During the review of December cash disbursements, the examiner noted that relatives of company personnel were being paid to do odd jobs for the company, such as hanging up Christmas lights or running errands. The company indicated that the payments were made as “Christmas bonuses” in appreciation of the help rather than reimbursements for specific expenses paid or hours worked on behalf of the company. Although these amounts were immaterial in relation to other expenses and did not appear to be unreasonable disbursements. Questions of impropriety could be raised by a third party. Especially since one of the payees was the spouse of the Accounts Payable Clerk. The examiners believes that the company could avoid any misinterpretations by third parties as to the propriety of these types disbursements by either having the Board approve the current procedure only with a monetary limit, or have the Board establish a new procedure where the President signs all bonuses or “appreciation” type payments. Either way any decision by the company on this matter should be noted in the minutes. It is suggested that the Board of Directors establish rules and limits for the paying of relatives and office personnel in appreciation of their work or help and record the action in the minutes.

The company is audited annually by an outside public accounting firm.

EDP Environment

Company personnel were interviewed with respect to the company's Electronic Data Processing environment. Access to the computer is limited to people authorized to use the computer.

Company personnel back up the computers daily and the backed-up data is kept off-site.

A manual which describes how to use the company's software and outlines the steps to complete specific tasks assists in the continuity of operations for seldom-used applications, training, or when staff turnover occurs. The company has manuals documenting the use of its software. Refer to the Net Unpaid Loss section for further discussion on documenting the use of applications.

Disaster Recovery Plan

A disaster recovery plan identifies steps to be performed in case the company loses a key employe, is not able to access its computer, information on its computer was lost, or the office building was destroyed, to name a few contingencies. The company has developed a disaster recovery plan. The company's disaster recovery plan appears to be adequate.

Invested Assets

Section 610.23, Wis. Stat., requires insurers to hold all investments and deposits of its funds in its own name except that:

> (1) Securities kept under a custodial agreement or trust arrangement with a bank or banking and trust company may be issued in the name of a nominee of the bank or banking and trust company; and
>
> (2) Any insurer may acquire and hold securities in bearer form.

For securities not held under a custodial agreement or trust arrangement with a bank or banking and trust company, s. Ins 13.05 (4), Wis. Adm. Code, requires that:

> Non-negotiable evidences of company investments such as registered bonds, certificates of deposits, notes, etc., shall be maintained in a safe

or vault with adequate safety controls or in a safety deposit box in a bank. Negotiable evidences of company investments shall be maintained in a safety deposit box in a bank. Access to a company safety deposit box containing negotiable securities shall require the presence and signature of at least 2 officers, directors or employes of the company.

The company is in compliance with these requirements.

Investment Rule Compliance

The investment rule for town mutual insurers allows a company to invest in common stocks, common stock mutual funds, and other higher risk investments (referred to as “Type 2”) provided that the town mutual has a sufficient amount of lower risk investments (referred to as “Type 1”). A town mutual may invest in Type 2 securities only if it already has sufficient Type 1 investments. Type 1 investments must equal or exceed the greater of items 1, 2, or 3.

1.	Liabilities plus $300,000	$742,978
2.	Liabilities plus 33% of gross premiums written	273,956
3.	Liabilities plus 50% of net premiums written	188,300
4.	Amount required (greater of 1, 2, or 3)	742,978
5.	Amount of Type 1 investments as of 12/31/2002	1,176,437
6.	Excess or (deficiency)	433,459

The company has sufficient Type 1 investments.

ASSETS

Cash and Invested Cash **$114,761**

The above asset is comprised of the following types of cash items:

Cash in company's office	$216
Cash deposited in banks-checking accounts	(8,292)
Cash deposited in banks at interest	122,837
Total	$114,761

Cash in the company's office at year-end represents the company's petty cash fund. A physical count was made by the examiners during the course of the examination and the balance reconciled to year-end.

Cash deposited in banks subject to the company's check and withdrawal consists of one account maintained in a local bank. Verification of checking account balances was made by obtaining confirmations directly from the depositor and reconciling the amounts shown thereon to company records.

Cash deposited in banks at interest represents a money market account and several certificates of deposit.. Deposits were verified by direct correspondence with the respective depositories and by an actual count and inspection of certificates and/or passbooks. Interest received during the year 2002 totaled $6,476 and was verified to company cash records. Rates of interest earned on cash deposits ranged from 1.09% to 5.70%. Accrued interest on cash deposits totaled $1,061 at year-end.

Book Value of Bonds **$1,408,705**

The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2002. Bonds owned by the company are located in either the company's locked fireproof filing cabinet or held at Waukesha State Bank under a safekeeping agreement.

Bonds were physically inspected by the examiners. Bond purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in bonds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Interest received during 2002 on bonds amounted to $110,305 and was traced to cash receipts records. Accrued interest of $26,199 at December 31, 2002, was checked and allowed as a nonledger asset.

Stocks and Mutual Fund Investments **$889,240**

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2002. Stocks owned by the company are located in either the company's locked fireproof filing cabinet or held at Waukesha State Bank under a safekeeping agreement.

Stock certificates were physically examined by the examiners. Stock and mutual fund purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in stocks and mutual funds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers. Dividends received during 2002 on stocks and mutual funds amounted to $28,181 and were traced to cash receipts records. There were no accrued dividends reported for either stock or mutual funds at December 31, 2002.

Book Value of Real Estate **$101,902**

The above amount represents the company's investment in real estate as of December 31, 2002. The company's real estate holdings consisted of its home office building located at 918 West Main Street in Waupun, Wisconsin.

The required documents supporting the validity of this investment were reviewed and were in order. Adequate hazard insurance was carried on the real estate and contents as noted under the caption, "Fidelity Bond and Other Insurance." The company's investment in real estate and related items was in conformance with the Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers. Real estate depreciation is calculated using the straight-line method.

Agents' Balances or Uncollected Premiums **$113,541**

The above ledger asset represents the amounts due from agents or policyholders which are not in excess of 90 days past due at year-end. A review of individual agent's accounts verified the accuracy of this asset.

Investment Income Due and Accrued **$26,260**

Interest due and accrued on the various assets of the company at December 31, 2002, consists of accrued interest from bonds and a small amount of accrued interest from an interest-bearing cash account.

Reinsurance Recoverable on Paid Losses **$ 2,869**

The above asset represents recoveries due to the company from reinsurance on losses which were paid on or prior to December 31, 2002. A review of year-end accountings with the reinsurer verified the above asset.

Equipment, Furniture, and Supplies **$1,929**

This asset consists of $1,929 of furniture and equipment owned by the company at December 31, 2002. In accordance with annual statement requirements, this amount has been deducted as an asset not admitted.

LIABILITIES AND SURPLUS

Net Unpaid Losses **$66,655**

This liability represents losses incurred on or prior to December 31, 2002, and remaining unpaid as of that date. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule. Differences may be reflected in the section of this report captioned "Reconciliation of Policyholders' Surplus."

	Company Estimate	Examiners' Development	Difference
Incurred But Unpaid Losses	$218,744	$174,938	$42,970
Less:			
Reinsurance Recoverable on Unpaid Losses	152,119	123,609	28,510
Net Unpaid Losses	$66,655	$51,119	$15,536

The examiners developed this liability by totaling actual loss payments made through the development period on those losses incurred on or prior to December 31, 2002. To the actual paid loss figures was added an estimated amount for those 2002 and prior losses unpaid at the examination date. The above difference of $15,536 between the developed loss reserve and the company estimate is due to favorable development in the company's incurred but not reported loss reserve. Since the current reserve development was not considered material to the company's financial position, no adjustment to surplus was made.

In order to develop this liability, the examiner requested various reports from the company's Pro-Claim system. For example, the company had trouble generating a report as of May 23, 2003 showing all closed claims with loss dates from 1998 to 2002. The examiner received a report with loss dates of 2002 and further attempts to generate the correct report proved unsuccessful. The examiner noted that the function to create this report was there but appeared not to be working. In order to obtain this information, the examiner used a Pro-Claim report showing all open claims as of 12/31/02. The report was printed on 4/23/03 and for each open claim with an accident year before 2002, the examiner had the company bring up the claim history and then noted the current status on the open claims report. This process was cumbersome for both the company and the examiner. The company should give consideration to any weaknesses or problems they've noted with the current software package and then contact the software developer for assistance.

The examiners' review of claim files included open claims, paid claims, claims closed without payment, and all claims which were denied during the examination period. The review indicated that claims are not always investigated and evaluated properly as detailed below. However, claim payments are made in accordance with policy provisions upon the submission of a proper proof of loss. In addition, the review of claims handling procedures and files revealed the following:

1. A proper loss register is maintained.
2. Claim files did not contained sufficient investigatory data and documentation to verify settlement payments or reserve estimates.
3. Proofs of loss were properly signed.

The examiner's review of a sample of claim files indicated that sufficient investigatory data and documentation to verify settlement or reserve estimate was not present for some of the items tested. For example, the company had replaced a piece of equipment for $15,250 that was lost due to a fire. However, the claim file did not contain any documentation indicating how the adjuster had arrived at the settlement amount or any receipt of purchase for the replacement. According to the company they rely on the adjusters' knowledge of current pricing based on auctions he or she has attended or prices in the paper and or classified ads for similar items. However, no documentation in support of this statement was in the claim file. If the adjuster is using any form of pricing guidance, it should be sufficiently documented in the claim file. If classified ads are the source then the file should contain copies of any recent classified ads for similar equipment. When the only source of how the company arrived at the claim payment amount is adjusters' knowledge, then it becomes even more difficult for the company to prove "fair and equitable settlement" as prescribed by Ins. 6.11 (3)(a)(4). This practice of not always having enough documentation in a claim file to justify the payment is one of the issues that should be addressed by the Executive/Adjusting Committee because the practice could be interpreted as a violation of unfair claims settlement practices due to the lack of verifiable justification for the payment, especially since the fire loss referred to earlier was settled the day after the claimant was elected as a director of the company. Also, without documentation to show how the company arrived at the settlement offer or payment, it is not clear that the company is “attempting in good faith to effectuate fair and equitable settlement of claims". It is recommended that the company establish procedures that will ensure that sufficient verifiable investigatory documentation be maintained that will justify claim payment amounts in accordance with Ins 6.11 (3) (a) 4, Wis. Adm. Code.

During the prior exam the examiners noted that the company routinely allowed claims to remain open beyond the one year statute of limitations defined in s. 631.83(1)(a), Wis. Stat., without settlement. The current examination noted that as of April 2003, when an open claims report was run, the company still is having some problems with timely settlement and in particular allowing fire claims to remain open beyond the one year statue of limitations. The open claims report showed that more than half of the 42 open claims had been open for 2 years or more. According to the company, they were either waiting for information from the claimant or for the insured to repair covered damages. This practice may be interpreted to be an unfair claim settlement practice by the company. It also increases the company’s exposure to additional loss sustained on damaged and unrepaired property. The examiner discussed the situation with the company. The company expressed concerns about what to do when the insured’s don’t respond and the examiner suggested that they contact OCI’s Bureau of Market Regulation with their concerns. After the company talked to an Insurance Examiner with Market Regulation, a draft of a follow-up letter to be sent to claimants was provided to the examiner and a copy was taken back to OCI for review by Market Regulation. The review by Market Regulation examiner indicated that the draft was deficient in that it did not include a specific date for the claimant to respond by. Correspondence to claimants indicating that a claim is to be closed must include a specific date for the required claimant response. Due to the fact that, as of the examination date, there were still numerous claims that had been open for multiple years and that the company that the company’s procedures were not clearly implemented in compliance with statutory requirements, it is again recommended that the company adopt procedures for timely settlement of claims, in compliance with s. Ins 6.11 (3) (a) 2, Wis. Adm. Code. As noted earlier in the report this is an area that could be handled by the Executive/Adjusting Committee and noted in the minutes.

Unpaid Loss Adjustment Expenses **$5,500**

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2002, but which remained unpaid as of year-end. The company judgmentally determines this liability.

The examiners' analysis of expenses incurred in the current year related to the settlement of prior year losses, as well as estimates of amounts necessary to settle any prior losses remaining unpaid at the examination date, determined this liability to be adequately stated.

Commissions Payable **$26,543**

This account consists of amounts due to agents for 2002 premiums. The company collects premiums directly from the insureds and then remits the commissions to the agents. Subsequent cash disbursements verified the above balance

Fire Department Dues Payable **$251**

This liability represents the fire department dues payable at December 31, 2002. The examiners reviewed the company's fire department dues calculation and found this liability to be correctly calculated. The actual amount paid was verified to the cash disbursement records.

Unearned Premiums **$304,426**

This liability represents the reserve established for unearned premiums in compliance with s. Ins 13.08 (3), Wis. Adm. Code. This reserve was established using a daily pro rata methodology.

Reinsurance Payable **$27,417**

This liability consists of amounts due to the company's reinsurer at December 31, 2002, relating to transactions which occurred on or prior to that date. The above amount represents deferred premiums the company owes its reinsurers under its 2002 reinsurance contract and its December 2002 reinsurance premium. Subsequent cash disbursements and reinsurance accountings verified the amount of this liability.

Amounts Withheld for the Account of Others **$1,728**

This liability represents employee payroll deductions in the possession of the company at December 31, 2002. Supporting records and subsequent cash disbursements verified this item.

Payroll Taxes Payable **$579**

This liability represents the company's portion of payroll taxes incurred prior to December 31, 2002, which have not yet been paid. Supporting records and subsequent cash disbursements verified this item.

Accounts Payable **$1,500**

This liability consists of amounts due to creditors for office and miscellaneous expenses at December 31, 2002. Supporting records and subsequent cash disbursements verified this item.

Accrued Property Taxes **$2,954**

This liability consists of personal and real estate property taxes due to the county, where the company’s home office is located, as of December 31, 2002. Supporting records and subsequent cash disbursements verified this item.

Premiums Received in Advance **$5,425**

This amount consists of premiums the company received in December 2002 for insurance coverages, which did not start until January 2003. A review of December 2002 premium receipts verified this balance.

V. CONCLUSION

The current examination resulted in five recommendations and two suggestions. Three recommendations were made regarding claim settlement practices, one of which was repeated from the prior examination. A recommendation was also made for the company to clarify the function of the adjusting committee so that it is performing appropriate duties. The prior exam contained a suggestion that the company develop a comprehensive business plan to aid in developing strategies for achieving short and long term goals as established by management and approved by the board of directors. The current examination changed this comment into a recommendation due to continuing underwriting losses. The remaining recommendations dealt with corporate records. The two suggestions dealt with the possible need for assistance using their Pro-Claim software and better internal control over certain disbursements. There were no adjustments to surplus as a result of this examination.

A decline in policies in force was noted during the prior examination. This trend continued during the period under the current examination with a 17% decline in policies in force since 1997. As mentioned in the Corporate Records section, developing a business plan would help the company develop strategies to address policyholder retention issues, encourage growth and reduce underwriting losses.

The company relies on investment income to offset underwriting losses and for three of the past five years the offset resulted in net income. However, severe storms that hit the area in 1998 and 2001 had a significant impact on the company’s operational results and net losses were reported in those years. These severe storms, especially those during 1998, have also increased the cost of reinsurance due to poor loss experience.

Overall surplus has decreased only slightly since the prior exam. This is primarily due to income from the company’s bond portfolio.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 16 - Corporate Records—It is recommended that the Secretary of the company maintain minutes from board, committee, and annual policyholders meetings that more clearly indicate that the Board of Directors are actively managing the company in compliance with s. 612.13(3) Wis. Stat.

2. Page 17 - Corporate Records—It is recommended that the company develop a comprehensive business plan to help provide assistance as to how it will achieve its goals.

3. Page 18 - Claims Adjusting—It is recommended that the company clarify the function of the adjusting committee such that it performs the role defined in s. 612.13 (4), Wis. Stat. and note it in the minutes.

4. Page 19 - Accounts and Records—It is suggested that the Board of Directors establish rules and limits for the paying of relatives and office personnel in appreciation of their work or help and record the action in the minutes.

5. Page 25 - Net Unpaid Losses—The company should give consideration to any weaknesses or problems they've noted with the current software package and then contact the software developer for assistance..

6. Page 27 - Net Unpaid Losses—It is recommended that the company establish procedures that will ensure that sufficient verifiable investigatory documentation be maintained that will justify claim payment amounts in accordance with Ins 6.11 (3) (a) 4, Wis. Adm. Code.

7. Page 27 - Net Unpaid Losses— It is again recommended that the company adopt procedures for timely settlement of claims, in compliance with s. Ins 6.11 (3) (a) 2, Wis. Adm. Code.

VII. ACKNOWLEDGMENT

The courteous cooperation extended to the examiners by the company's personnel is hereby acknowledged.

In addition to the undersigned, Amy Wolff, of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Respectfully submitted,

Eleanor Oppriecht
Examiner-in-Charge